

REPORT ON EXAMINATION

OF THE

UNITED STATES FIRE INSURANCE COMPANY

AS OF

DECEMBER 31, 2004

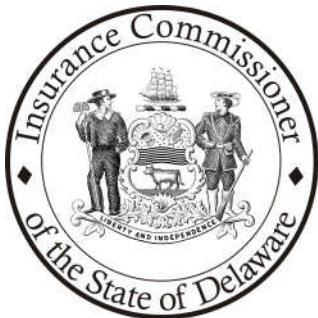
I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of DECEMBER 31, 2004 of the

UNITED STATES FIRE INSURANCE COMPANY

is a true and correct copy of the document filed with this Department.

ATTEST BY: Antoinette Handy

DATE: 19 JUNE 2006



In Witness Whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 19TH DAY OF JUNE 2006.

Matthew Denn
Insurance Commissioner

REPORT ON EXAMINATION
OF THE
UNITED STATES FIRE INSURANCE COMPANY
AS OF
December 31, 2004

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Matthew Denn", written over a horizontal line.

MATTHEW DENN
INSURANCE COMMISSIONER

DATED this 19TH Day of JUNE 2006.

| <u>Table of Contents</u> | Page |
|--|------|
| SALUTATION | 1 |
| SCOPE OF EXAMINATION..... | 2 |
| HISTORY | 3 |
| CAPITALIZATION..... | 4 |
| MANAGEMENT AND CONTROL | 5 |
| AGREEMENTS..... | 7 |
| INSURANCE HOLDING COMPANY SYSTEM..... | 12 |
| TERRITORY AND PLAN OF OPERATION..... | 16 |
| GROWTH OF COMPANY | 16 |
| REINSURANCE..... | 18 |
| Assumed – non affiliated | 18 |
| Ceded | 18 |
| FINANCIAL STATEMENTS | 25 |
| Analysis of Assets..... | 26 |
| Liabilities, Surplus and Other Funds | 27 |
| Underwriting and Investment Exhibit: Statement of Income | 28 |
| Capital and Surplus Account | 28 |
| Examination Adjustments | 29 |
| NOTES TO FINANCIAL STATEMENTS | 29 |
| COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS | 33 |
| SUMMARY OF RECOMMENDATIONS | 33 |
| CONCLUSION..... | 34 |
| SUBSEQUENT EVENTS | 35 |

SALUTATION

December 15, 2005

Honorable Alfred W. Gross, Chairman
Financial Condition Subcommittee, NAIC
2301 McGee Street, Suite 800
Kansas City, Missouri 64108-2662

Honorable Susan F. Cogswell, Commissioner
Secretary Northeastern Zone
State of Connecticut
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Honorable Merwin Stewart, Director
Secretary Western Zone
State of Utah
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State Office Building, #3110
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Honorable Sally McCarty, Commissioner
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Honorable Alfred W. Gross, Commissioner
Secretary Southeastern Zone
Commonwealth of Virginia
State Corporation Commission
Bureau of Insurance
P. O. Box 1157
Richmond, Virginia 23218

Honorable Matthew P. Denn
Insurance Commissioner
State of Delaware
841 Silver Lake Boulevard, Suite 100
Dover, Delaware 19904

Commissioners:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority Number 05.004, an examination has been made of the affairs, financial condition and management of

UNITED STATES FIRE INSURANCE COMPANY

hereinafter referred to as “Company” or “USF” incorporated under the laws of the State of Delaware. The examination was conducted at the main administrative office of the Company located at 305 Madison Avenue, Morristown, New Jersey. Service of process address is 2711

Centerville Road, Suite 400, Wilmington, Delaware 19808. A pooled examination of the Company was conducted concurrently with that of its affiliates, Crum & Forster Indemnity Company (CFIC), a Delaware Company, The North River Insurance Company (NRIC), a New Jersey Company and Crum and Forster Insurance Company (CFInsko), a New Jersey Company. Separate reports of examination were filed for each company.

The report of examination thereon is respectfully submitted.

SCOPE OF EXAMINATION

The last examination of the Company covered the period January 1, 1999 to December 31, 2001 and was conducted by the State of New York. The Company re-domesticated to the State of Delaware effective December 31, 2003. The examination of the Company covered the period from January 1, 2002, through December 31, 2004, and consisted of a general survey of the Company's business policies and practices; management, any corporate matters incident thereto; a verification and evaluation of assets and a determination of liabilities. Transactions subsequent to the latter date were reviewed to the extent deemed necessary.

The format of this report is designed to explain the procedures employed on the examination and the text will explain changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible personnel and/or officials during the course of the examination.

The general procedure of the examination followed rules established by the National Association of Insurance Commissioners (NAIC) Committee on Financial Condition

Examiners Handbook as adopted by the Delaware Insurance Department and generally accepted statutory insurance examination standards.

In addition to items noted in this report, the following topics were reviewed without exception and are included in the workpapers of this examination:

- Fidelity Bond and Other Corporate Insurance
- Corporate Records
- Employees and Agents Welfare
- NAIC Ratios
- Legal Actions
- Regulatory Agency Correspondence
- Schedule of Examination Changes
- All asset and liability items not mentioned

Workpapers prepared by the Company's external accounting firm, PricewaterhouseCoopers, (PwC) New York, New York, in connection with their annual audit, were reviewed and relied upon to the extent possible.

INS Services, Inc. was retained by the Delaware Insurance Department to conduct a review of the overall risks related to information system controls.

HISTORY

The Company was incorporated under the laws of New York on April 1, 1824. The Company absorbed by merger: the Peter Cooper Insurance Company of New York in September, 1911; the Williamsburg City Fire Insurance Company of New York on October 31, 1916; the Colonial Assurance Corporation of New York on December 21, 1922, the Allemannia Fire Insurance Company of Pittsburgh on May 31, 1951 and the Southern Fire Insurance Company on September 21, 1956.

Effective December 31, 2003, the United States Fire Insurance Company, a New York domiciled Company, was merged with and into the United States Fire Insurance Company a Delaware domiciled property and casualty insurance company, formerly known as MJR Fire Insurance Company. During 2003 MJR Fire Insurance Company was incorporated in Delaware as a wholly-owned subsidiary of United States Fire Insurance Company. In connection with the merger, MJR Fire Insurance Company's name was changed to United States Fire Insurance Company and became the wholly-owned subsidiary of Crum & Forster Holding Inc., which is a wholly-owned subsidiary of Crum & Forster Holdings Corp., a Delaware corporation (Holdings).

CAPITALIZATION

At December 31, 2004, the Company had 2,242,187 common shares authorized with a par value of \$3 per share, of which 1,528,754 shares were issued and outstanding. The schedule below shows the changes in the Company's capital and surplus from the previous examination to the current examination.

| | Special Surplus Funds (3) | Common Capital Stock | Gross Paid -in & Contributed Surplus | Unassigned Funds (Surplus) | Total |
|---------------------------|--|---------------------------------|---|---|-----------------------------|
| 12/31/01 | \$500,304,731 | \$4,586,262 | \$274,329,699 | \$(265,692,898) | \$513,527,794 |
| | | | | | |
| Operations (1) | | | | | |
| 2002 Operations | 4,875,020 | | | 85,019,676 | 89,894,696 |
| 2003 Operations | (129,719,351) | | | 326,317,720 | 196,598,369 |
| 2004 Operations | 47,756,067 | | | 111,743,967 | 159,500,034 |
| | | | | | |
| Mergers (2) | 5,006,139 | | 5,000,000 | (4,246,089) | 5,760,050 |
| | | | | | |
| Dividends Paid (4) | | | | | |
| 2004 Dividends Paid | | | | <u>(80,000,000)</u> | <u>(80,000,000)</u> |
| | | | | | |
| 12/31/04 | <u>\$428,222,606</u> | <u>\$4,586,262</u> | <u>\$279,329,699</u> | <u>\$173,142,376</u> | <u>\$885,280,943</u> |

- (1) Operations is defined as: Net income, net unrealized capital gains or loss, change in net unrealized foreign exchange capital gain or loss, change in net deferred income tax, change in non-admitted assets, change in provision for reinsurance, cumulative effect of changes in accounting principles and aggregate write-ins for gains and losses in surplus.
- (2) On July 1, 2004, the Company's affiliate Crum & Forster Underwriters Co. of Ohio (C&F Ohio) merged into the Company. The Company became the combined surviving entity by operation of law.
- (3) The change in special surplus is due to retroactive reinsurance that is required to be accounted for as a write-in item under SSAP No. 62 (refer to Notes to the Financial Statements for information related to Special Surplus).
- (4) Dividends paid were considered ordinary and were reported properly to the Delaware Department of Insurance.

MANAGEMENT AND CONTROL

Pursuant to the General Corporation Law of the State of Delaware, as implemented by the Company's Certificate of Incorporation and By-Laws, all corporate powers and its business property and affairs are managed by or under the direction of its Board of Directors. The Board shall consist of a minimum of three (3) members and subject to a maximum of seven (7) members.

The Board of Directors at December 31, 2004, was comprised of three (3) members, each elected or appointed in accordance with Company By-Laws. Each Director shall hold office until his successor is elected and qualified, or until earlier resignation or removal.

The members of the Board of Directors serving as of December 31, 2004, were as follows:

| <u>Director's Name</u> | <u>Principal Business Affiliation</u> |
|--------------------------------|--|
| Nikolas Antonopoulos, Chairman | Crum & Forster Holdings Corp. |
| Joseph Francis Braunstein, Jr. | Crum & Forster Holding Inc. |
| Mary Jane Robertson | Crum & Forster Holdings Corp. |

The Company's by-laws provide for the Board to designate one or more committees. The Company's only active committee as of December 31, 2004, was the Executive Committee. The Board members serving on the Executive Committee were as follows:

Nikolos Antonopoulos Joseph F. Braunstein, Jr. Mary Jane Robertson

The By-Laws of the Company state the principal officers of the corporation shall be a President, a Chairman of the Board of Directors, a Chief Executive Officer, and any other Vice-Presidents, a Treasurer, a Secretary, one or more Assistant Vice Presidents, one or more Assistant Secretaries, and such other officers, assistant officers or agents as the Board of Directors from time to time may determine.

At December 31, 2004, the Company's principal officers and their respective titles were as follows:

| <u>Officer</u> | <u>Title</u> |
|---------------------------|--|
| Nikolas Antonopoulos | Chairman of the Board & CEO |
| Joseph F. Braunstein, Jr. | President |
| Mary Jane Robertson | Senior Executive Vice President, Treasurer & CFO |
| Valerie J. Gasparik | Vice President & Secretary |
| Peter J. Daly | Senior Vice President |
| Donald R. Fischer | Senior Vice President |
| John J. French | Senior Vice President |
| Dennis J. Hammer | Senior Vice President & Controller |
| Mary J. Hughes | Senior Vice President |
| Paul Kush | Senior Vice President |
| Daniel G. Meyer | Senior Vice President |
| Kim E. Piersol | Senior Vice President |

The minutes of the meetings of the Stockholder and Board of Directors, which were held during the period of examination, were read and noted. Attendance at meetings, election of Directors and Officers and approval of investment transactions were also noted.

Inspection of Company files indicated that ethics statement/conflict of interest affidavits were distributed, completed and returned by all employees at the Assistant Secretary level or above for the examination period.

During our review for Compliance with Section 4919 of the Delaware Insurance Code, it was noted that the Company properly reported changes in directors and principal officers after re-domesticating from New York to Delaware.

AGREEMENTS

Service Agreements

Administrative Services Agreement

Effective January 1, 1993 the Company entered into administrative services agreements with pooled participants (refer to reinsurance section). An amendment dated June 12, 1995 added Crum & Forster Indemnity Company. Crum & Forster Specialty Insurance Company (C&F Specialty) was added effective December 21, 2000. The Company provides all administrative services such as underwriting, claims handling, reinsurance and premium collections on behalf of the parties. Operating expenses incurred in the performance of services are allocated in accordance with SSAP No. 70. Pool participants are charged their respective shares of operating expenses. Expenses allocated under this agreement in 2004 were 76%, or approximately \$131,476,000.

Administrative Agreement

Effective January 1, 2005, the Company entered into an administrative services agreement with Seneca Specialty Insurance Company (Seneca Specialty), an Arizona Company. The Company provides Seneca Specialty with certain underwriting and administrative services. Seneca Specialty agrees to pay all costs and expenses incurred by the Company.

Administrative Service Agreement

Effective August 31, 2000, the Company entered into an administrative services agreement with Seneca Insurance Company, Inc. (SIC), a New York insurer and wholly owned by The North River Insurance Company, an affiliate, incorporated in New Jersey. The Company provides SIC with certain underwriting and administrative services. SIC agrees to pay all costs and expenses incurred by the Company. Expenses allocated under this agreement in 2004 were approximately \$5,169,000.

Information Technology Agreement

Effective September 1, 2001, the Company agreed to certain information technology services from Fairfax Information Technology Services, Inc. (FITS), a wholly-owned subsidiary of Fairfax Inc., a Wyoming corporation (Parent). Costs and expenses incurred are allocated in accordance with SSAP No. 70, Allocation of Expenses. The Company incurred expenses under this agreement in 2004 of approximately \$10,993,000.

Tax Allocation Agreement

Effective January 1, 2000, the Company entered into a tax allocation agreement with the Parent along with certain of its affiliates. The Parent, the Company, and affiliates

constitute an affiliated group and have elected to file a consolidated return under the provisions of Section 1501 of the Internal Revenue Code of 1986. Pursuant to the terms of the tax allocation agreement, no party will be required to pay more in taxes nor receive a lesser payment of a refund than it would have paid or received if it computed its taxes independently and filed a separate tax return. Additionally, the Company has an enforceable right to recoup federal income taxes paid in prior years in the event of future net losses, which it may incur, or to recoup its net losses carried forward as an offset to future net income subject to federal income taxes.

Investment Agreement

Effective October 1, 2002 the Company entered into an investment agreement with Hamblin Watsa Investment Counsel Ltd. (Hamblin Watsa) and the Company's ultimate parent, Fairfax Financial Holdings Limited (FFH), to provide various investment management services to the Company. The agreement authorizes Hamblin Watsa to supervise and direct all investments and to exercise whatever powers the Company may possess with respect to its invested assets. Investment transactions will be in accordance with investment objectives of the Company and subject to restrictions established by the Company, as communicated to Hamblin Watsa in writing from time to time.

Subject to these limitations, Hamblin Watsa may buy, sell, exchange, convert and otherwise trade in and engage in investment transactions of any nature whatsoever involving any stocks, bonds, commercial paper, money market instruments and other securities and assets when it deems appropriate and without prior consultation with the Company. The Company's allocated investment management fees for 2004 amounted to \$5,578,000.

Escrow Agreement

Effective December 23, 2002, the Company entered into an escrow agreement with the Parent, CFIC, SIC and The Bank of New York. The Insurance Department of the State of New York required the escrow account be established and maintained to assure the domestic insurer's enforceable right to recoup federal income tax in the event of future losses.

Claims Service and Management Agreement

Effective July 1, 2000, the Company entered into a claims services and management agreement with RiverStone Claims Management LLC, (RiverStone) a Delaware limited liability company and an affiliate, wholly owned by the Parent. RiverStone provides the Company claims services for certain identified types of claims. In 2004, the Company agreed to pay a base service fee in the amount of two million seven hundred thirty-six thousand dollars (\$2,736,000) per annum. Fees are payable monthly in arrears on the last day of each calendar month and in an amount equal to one-twelfth of the annual fee. Expenses incurred under this agreement during 2004 were \$2,736,000.

Environmental Claims Services Agreement

Effective January 1, 1993 the Company entered into an environmental claims services agreement with International Insurance Company (IIC), an Illinois insurer. IIC provides the personnel and facilities for the processing, adjustment and settling of environmental insurance claims. The Company agrees to reimburse all costs and expenses incurred by IIC. Amounts incurred by the Company for services provided by IIC under this agreement in 2004 were \$25,000.

Reinsurance and Insurance Management and Services Agreement

Effective January 1, 1993, the Company entered into a reinsurance and insurance management services agreement with IIC. IIC provides the Company with management of certain reinsurance recoverables and for runoff along with performing discontinued operations previously done by certain of the Crum & Forster business units on behalf of the Company. The Company agrees to pay all costs and expenses incurred by IIC. During 2004, the Company paid \$4,000 for services performed under this agreement.

Master Repurchase Agreement

Effective July 1, 2000, and with an amendment dated September 11, 2001, the Company entered into a master repurchase agreement with FFH. The agreement provides for the repurchase of securities that are transferred to FFH from time to time in order to provide liquidity in the event that the Company is required to pay claims or other corporate obligations, subject to an aggregate limitation for USF and NRIC of \$100 million and \$5 million for CFIC and CFInsko. Under the agreement, the Company is obligated to repurchase from FFH securities that are transferred for this purpose before the end of each calendar year in which the original purchase took place at a price equal to the amount initially raised from their sale plus the stated interest rate for each security pursuant to the initial sale. During the time that such securities are transferred to FFH, the Company is entitled to receive income payable on such securities. There were no transactions under this agreement during 2004.

Commutation and Release Agreement

Effective December 31, 2003 the Company entered into a commutation and release agreement, along with SIC, CFIC, CFInsko, NRIC, C&F Ohio (now merged with the

Company), C&F Specialty, Seneca Specialty (collectively hereafter the “Reinsured”), and nSpire Re Limited (hereafter the “Reinsurer”). The Reinsured and Reinsurer desired to fully and finally settle and commute their respective past, present and future obligations and liabilities, known and unknown, associated with accident year 2001 of the aggregate stop-loss agreement.

TIG Service Agreement

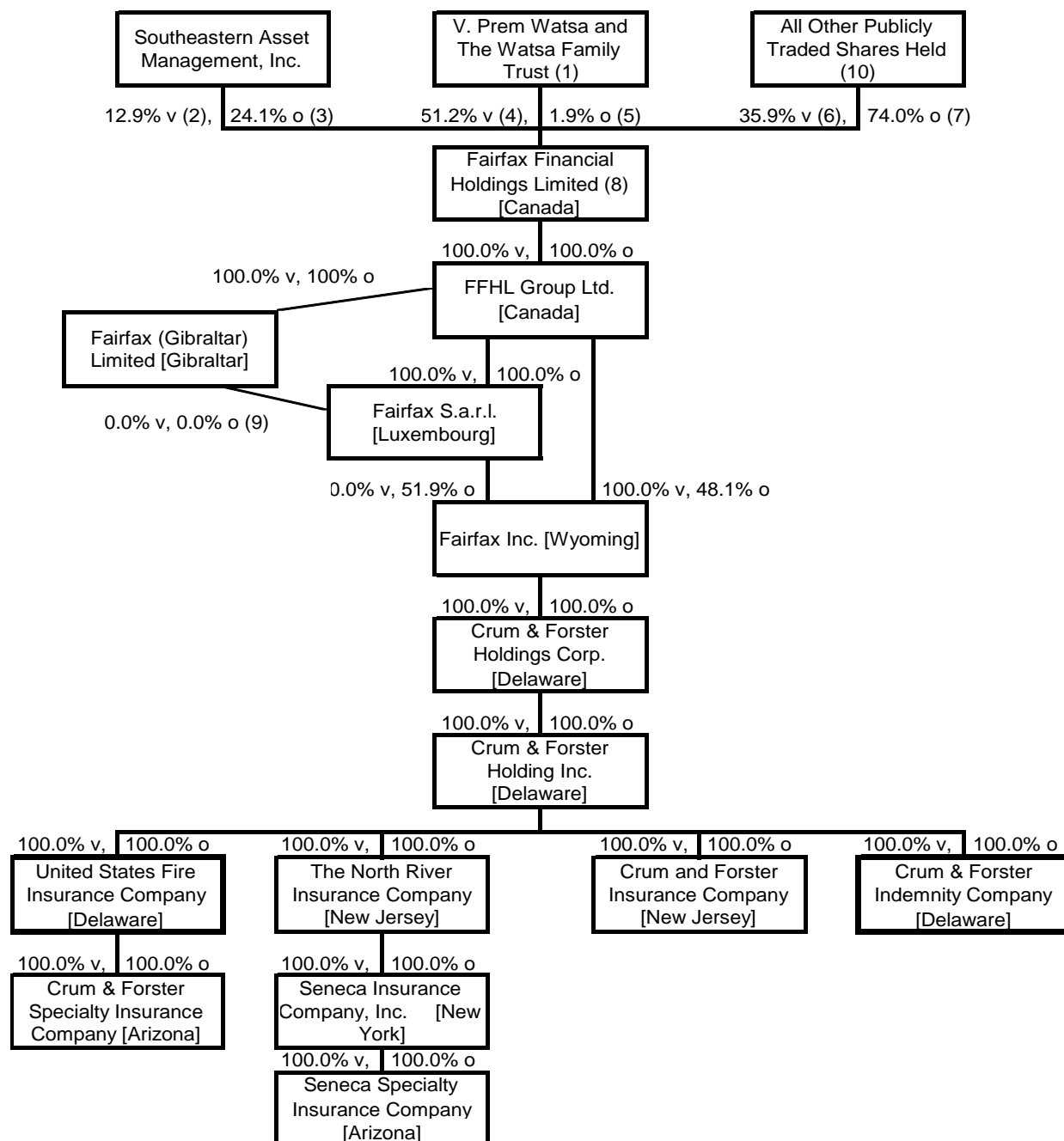
Effective January 1, 2000, the Company entered into a Service Agreement with TIG Insurance Company (TIG). TIG provides certain services relating to the underwriting, issuance and delivery of policies, and handling of claims in the state of Hawaii. TIG is reimbursed for expenses budgeted and agreed upon for a year and paid quarterly (at the beginning of the quarter). Amounts incurred by the Company for services provided by TIG under this agreement in 2004 were \$ 85,000.

INSURANCE HOLDING COMPANY SYSTEM

The Company is a member of an insurance holding company system as defined under Title 18, Chapter 50, “Insurance Holding Companies” of the Delaware Insurance Code. Holding Company registration statements were properly filed by the Company with the Delaware Insurance Department.

All of the common stock is owned by Crum & Forster Holding Inc., a Delaware Holding Company. The ultimate controlling entity of the holding company system is FFH, a Canadian holding company. FFH’s stock is traded on the Canadian Stock Exchange under the symbol “FFH”. As of December 31, 2004, FFH reported approximately \$26.33 billion in assets and \$3.2 billion in capital and surplus on a consolidated GAAP basis.

The following organizational chart, of which the Company is a part, illustrates the identities and relationships between its parent, affiliates and subsidiaries as of December 31, 2004.



The below notes 1 through 10 were discerned through the examination and more fully describe the ownership and voting percentages throughout the Holding Company:

v = voting control

o = ownership control

- (1) through voting and ownership control, both directly and indirectly, of the following individual and entities: Mr. V. Prem Watsa, 1109519 Ontario Limited, 810679 Ontario Limited and The Sixty Two Investment Company Limited
- (2) calculated as 3,974,780 votes (3,974,780 subordinate common shares held) divided by 30,822,759 votes [See note (8)]
- (3) calculated as 3,974,780 subordinate common shares held / 15,342,759 total subordinate common shares times \$1,781,800,000 / \$1,918,400,000 [See note (8)]
- (4) calculated as 0.8% through V. Prem Watsa and 50.4% through The Watsa Family Trust and the three entities described in (1). The 0.8% is calculated as 159,735 subordinate voting common shares (159,735 votes) through 810679 Ontario Limited and 96,568 subordinate voting common shares (96,568 votes) held personally by Mr. V. Prem Watsa, which equals 256,303 votes divided by 30,822,759 total votes. The 50.4% is calculated as 50,620 subordinate voting common shares (50,620 votes) plus 1,548,000 multiple voting common shares (15,480,000 votes) held through The Watsa Family Trust, 1109519 Ontario Limited and The Sixty Two Investment Company, which equals 15,530,620 votes divided by 30,822,750 total votes. [See note (8)]
- (5) calculated as 306,923 subordinate common shares held (256,303 plus 50,620 [See (4)]) / 15,342,759 total subordinate voting common shares times \$1,781,800,000 / \$1,918,400,000 [See note (8)]
- (6) 100.0% minus 12.9% (2) minus 51.2% (4)
- (7) 100.0% minus 24.1% (3) minus 1.9% (5)
- (8) common shares are publicly traded on the Toronto Stock Exchange in Canada and the New York Stock Exchange in the U.S. under the symbol "FFH". The Company has issued at 12/31/04 1,548,000 multiple voting common shares (which carry ten votes per share), 15,342,759 subordinate voting common shares (which carry one vote per share) and 8,000,000 non-voting preferred Series A shares. Total votes are 30,822,759 consisting of the 15,480,000 votes attributable to the multiple voting common shares and 15,342,759 votes attributable to the subordinate voting common shares. Fairfax's capital account at 12/31/04 totals \$1,918,400,000 (U.S.), which consists of common shares totaling \$1,781,800,000 (92.9% of the total) and preferred shares totaling \$136,600,000 (7.1% of the total).

- (9) 0% ownership and 0% voting control but entity holds non-voting preferred shares issued by Fairfax S.a.r.l.
- (10) No entity or individual owns or controls greater than 10% as of 12/31/04, but as of 3/31/05, Goldman Sachs owned 1,800,176 subordinate voting common shares, which represented 5.8% voting control (1,800,176 divided by 30,822,750 total votes) and 10.9% ownership control (1,800,176 divided by 15,342,759 times \$1,781,800,000 divided by \$1,918,400,000).

It was noted during our review that the Company's filed annual statement did not reflect the proper ownership percentages. Subsequent to the examination the error regarding ownership percentages was corrected. Voting percentages, however, remain undisclosed and should be disclosed on the holding company chart. Therefore,

It is recommended that the Company properly disclose the Holding Company voting structure in the filed Annual statement (refer to summary of recommendations).

It was observed that Southeastern Asset Management had filed and received a disclaimer of control and exemption under Section 5003(e)(2) regarding control of greater than 10% of the securities of FFH. This filing was accepted by the Delaware Department of Insurance on November 22, 2004. Southeastern Asset Management was identified in the 2004 Holding Company Registration Statement as controlling more than 10% of the voting stock of FFH [statement claimed 25% but actual was 12.9% voting control and 24.1% ownership control]. V. Prem Watsa, who had 51.2% voting control of FFH and 1.9% ownership control of FFH, was identified in the holding company registration statements for the years under examination as the "Chairman" of the ultimate controlling entity, FFH.

Subsequent to the examination date, another entity, Goldman Sachs, had amassed 5.8% voting control of FFH and 10.9% ownership control of FFH during the first quarter 2005.

TERRITORY AND PLAN OF OPERATION

Territory

As of December 31, 2004, the Company was licensed to transact multiple property and casualty lines of insurance in 50 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands.

Plan of Operation

The Company is a commercial property and casualty insurance company that targets specialty classes of business and overlooked market opportunities. The Company writes business through independent retail agents and brokers, and national and wholesale brokers. The Company's underwriting strategy focuses on applying individual risk selection to business that requires greater underwriting expertise. The Company's principal lines of business include commercial auto, workers' compensation, general liability and fire and allied lines. Under the terms of a pooling agreement, the Company (as Pool lead) assumes from pool participants, 100% of premiums, losses, dividends to policyholders and other underwriting expenses. The Company retains 76% of all business (see Reinsurance ceded for more information).

GROWTH OF COMPANY

The following information was obtained from the Company's filed Annual Statements and covers the period from the prior examination to December 31, 2004, and reflects changes made for the current examination:

| Year | Net Written Premiums | Net Admitted Assets | Liabilities | Policyholder Surplus | Net Income |
|-------------|-----------------------------|----------------------------|--------------------|-----------------------------|-------------------|
| 2001 | \$367,247,543 | \$1,990,908,918 | \$1,477,381,124 | \$513,527,794 | (\$47,157,506) |
| 2002 | 433,157,499 | 2,006,286,301 | 1,402,863,811 | 603,422,490 | 31,728,057 |
| 2003 | 585,382,423 | 2,597,113,133 | 1,797,092,274 | 800,020,859 | 163,446,532 |
| 2004 | 605,581,644 | 2,934,247,259 | 2,048,966,316 | 885,280,943 | 43,569,669 |

The growth over the examination period is noted as follows:

- A 64.9% increase in net written premiums
- A 47.4% increase in assets
- A 38.7% increase in liabilities
- A 72.4% increase in policyholder surplus
- A 192.4% increase in net income

The Company reported net income of \$43,569,669 for 2004 compared to \$(47,157,506) for 2001. The increase of \$90,727,175 from 2001 to 2004 mainly reflects lower incurred losses, loss expenses and other underwriting expenses incurred. The market was soft during 2002 and there were severe losses in 2001 due to the September 11 attacks. The insurance market firmed up in 2003.

Net realized capital gains (exclusive of capital gains taxes) reported for the years under examination were \$53,091,871, \$202,040,028 and \$13,972,661 for the years 2004, 2003 and 2002, respectively. Without the large net realized capital gains during 2003, the Company would have experienced a net loss. The net realized capital gains during 2004 were offset by other realized adjustments of \$(17,632,195) for mark-to-market adjustments on secured borrowing (refer to note 7 of the Notes to Financial Statements for more information regarding this matter).

REINSURANCE**General**

For 2004, the Company reported the following distribution of net written premiums:

| | | |
|---|--|----------------------|
| Total Direct Written Premiums | | \$728,728,136 |
| Assumed premiums non affiliated | | 10,360,225 |
| Assumed premiums affiliated | | 67,935,022 |
| Assumed Affiliated Premium Written–Pool | | <u>159,827,890</u> |
| Total Gross Premiums | | \$966,851,273 |
| Ceded premiums: | | |
| Ceded to pool | | \$232,044,475 |
| Ceded to third party | | <u>129,225,154</u> |
| Total Ceded Premiums | | <u>\$361,269,629</u> |
| Net Written Premiums | | <u>\$605,581,644</u> |

Percentage Ceded of Gross

37.0%

Assumed – non affiliated

In addition to assumptions from the pool participants, the Company has only two other significant sources of assumed business, an 80% quota share with C&F Specialty and mandatory pools. The premiums assumed for C&F Specialty and the mandatory pools for 2004 were \$65,061,000 and \$10,131,000, respectively.

Ceded

The Company is a 76% participant in a pool with its affiliates. Effective January 1, 2000, the Company and certain affiliates (Pool Participants) entered into a reinsurance participation agreement by which premiums, losses, dividends to policyholders and other underwriting expenses of each participant are pooled by means of mutual reinsurance on a fixed percentage basis as follows:

| <u>Pool Participants</u> | |
|--------------------------------------|-----|
| United States Fire Insurance Company | 76% |
| The North River Insurance Company | 22% |
| Crum and Forster Insurance Company | 1% |
| Crum & Forster Indemnity Company | 1% |

The Agreement provides that the Company, acting as lead company, assumes from the Pool Participants 100% of their premiums, losses, dividends to policyholders and other underwriting expenses.

The Company purchases reinsurance to limit its exposure to loss from any one claim or occurrence (“per risk reinsurance”), and aggregate loss experience for an accident year that exceeds an amount the Company is willing to accept (corporate aggregate reinsurance). The Company’s corporate aggregate reinsurance contracts are the type most commonly referred to as “finite” reinsurance and cover or covered, in varying amounts and on varying terms, accident years 2002 and prior. No such reinsurance has been purchased for subsequent accident years.

As of the Examination date, the Company had the following significant reinsurance contracts:

Per risk

| <u>Line of Business</u> | <u>Term</u> | <u>Layer/ Limit</u> | <u>Placement</u> | <u>Affiliate Participation</u> |
|--------------------------------------|-------------------|---|------------------|--------------------------------|
| Terrorism –Fairfax | 1/1/04 - 12-31-04 | a) 90% of Underwriting net Loss excess of \$98.3 million est (10% 2003 DEP) b) 90% of Underwriting Net Loss excess of Fairfax Group deductible | 100% | 100% nSpire |
| Property Per risk XOL – 1st Layer | 3/1/04 - 2/28/05 | \$3 million xs \$2 million \$15.0 million per occurrence Certified terror excluded reinstatements free & unlimited | 100% | nSpire 7.5% Odyssey 5% |

| <u>Line of Business</u> | <u>Term</u> | <u>Layer/ Limit</u> | <u>Placement</u> | <u>Affiliate Participation</u> |
|--------------------------------------|-----------------------|--|-------------------------|---------------------------------------|
| Property Per risk XOL – 2nd layer | 3/1/04 - 2/28/05 | \$5 million xs \$5 million \$20.0 million per occurrence Certified terror excluded reinstatement. Free & unlimited | 100% | nSpire 7.5% Odyssey 5% |
| Property Per risk XOL – 3rd layer | 3/1/04 - 2/28/05 | \$15 million xs \$10 million \$30.0 million per occurrence Certified terror excluded Reinstatement 3 Free & 1 @ 100% | 100% | nSpire 5% |
| Property Catastrophe – 1st Layer | 5-1-04 - 4- 30-05 | \$55 million xs \$25 million Certified terror excluded Reinstatement, 1 @100% | 97.50% | nSpire 13% Odyssey 6% |
| Property Catastrophe – 2nd Layer | 5-1-04 - 4- 30-05 | \$100 million xs \$80 million Certified terror excluded Reinstatement: 1 @100% | 97.50% | nSpire 10% Odyssey 5% |
| Property Catastrophe – 3rd Layer | 5-1-04 - 4- 30-05 | \$140 million xs \$180 million Certified terror excluded Reins:1 @100% | 97.50% | nSpire 10% |
| Umbrella Per risk XOL – 1st Layer | 10-1-04 to 9-30-05 | \$2 million xs \$1 million Cert. terror included 1 limit per occurrence, 2 limit aggregate | 50% | nSpire 20% |
| Umbrella Per risk XOL – 2nd Layer | 10-1-04 to 9-30-05 | \$7 million xs \$3 million Cert. terror included 1 limit per occurrence, 2 limit aggregate | 100% | nSpire 20% Odyssey 5% |
| Umbrella Per risk XOL – 3rd Layer | 10-1-04 to 9-30-05 | \$15 million xs \$10 million Cert. terror included 1 limit per occurrence, 2 limit aggregate | 100% | nSpire 20% Odyssey 5% |
| Workers Comp XOL - 1st layer | 4-1-04 - 3- 31-05 | \$3 million xs \$2 million Terror, Cert. / Non Cert. Max terror unlimited Reinstatement Free & unlimited | 75% | nSpire 25% |
| Workers Comp XOL - 2nd layer | 4-1-04 – 3-31-05 | \$5 million xs \$5 million Terror, Cert. / Non Cert. | 90% | |

| <u>Line of Business</u> | <u>Term</u> | <u>Layer/ Limit</u> | <u>Placement</u> | <u>Affiliate Participation</u> |
|--------------------------------------|-------------------------|--|------------------|--------------------------------|
| | | Max terror \$10 million Reinstatement Free & unlimited | | |
| Workers Comp XOL - 1st layer Cat. | 4-1-04 – 3-31-05 | \$10 million xs \$10 million Terror, Cert. / Non Cert Max terror \$10 million Reinstatement 1 Free, Max limit \$10 million | 100% | nSpire 5% |
| Workers Comp XOL - 2nd layer Cat. | 4-1-04 – 3-31-05 | \$30 million xs \$20 million Terror, Cert. / Non Cert. Max terror \$30 million Reins. 1 @ 100%Max limit \$10 million | 100% | |
| Workers Comp XOL - 3rd layer Cat. | 4-1-04 – 3-31-05 | \$50 million xs \$50 million Terror, Cert. / Non Cert. Max terror \$50 million Reinstatement 1 @ 100% Max limit \$10 million | 100% | nSpire 5% |
| Workers Comp XOL - 4th layer Cat. | 4-1-04 – 3-31-05 | \$100 million xs \$100 million Terror, Non Cert. Reinstatement 1 @ 100%Max limit \$5 million | 100% | nSpire 2.5% |
| Surety - Variable Q/S | 5-1-04 – 4-30-05 | \$35 million Certified terror exclusion | 100% nSpire | 100% nSpire |
| Surety XOL | 5-1-04 – 4-30-05 | \$7.5 million xs \$7.5 million (\$22.5 aggregate) Certified Terror exclusion reinstatements: 2 @ 100% | 90% | nSpire |
| Mgmt Protection Excess Risk Q/S | 6-1-04 – 5-31-05 | \$0.0 - \$5 million 60/40 \$5.0 - \$10 million 80/20 NO terror exclusion | 100% | nSpire |
| Mgmt Protection Primary Risks EOL | 6-1-04 – 5-31-05 | \$8.0 million xs \$2.0 million No terror exclusion | 100% | nSpire |
| Fidelity Q/S | 6-1-04 to continuous | Q/S up to \$5 million No terror exclusion | 80% | |

Corporate Aggregate

As of the examination date, the Pool Participants have a prospective contract covering accident year 2002 with an unused limit of \$96.3 million for the Pool Participants, in the event the loss and LAE ratio for accident year 2002 before the effect of the contract exceeds 70%. The subject loss and LAE ratio as valued at examination date was 63.2%. The reinsurer is an affiliate, nSpire, a wholly owned subsidiary of FFH.

Finite

The Pool Participants entered into an aggregate stop loss agreement with an unaffiliated reinsurer covering accident year 2000, which provided coverage of \$118,493,000, which has been fully utilized by the Pool Participants as of December 31, 2004. Premiums and losses ceded pursuant to the contract were \$7,595,000 and \$9,994,000, respectively, in 2004 and there were no cessions in 2003 and 2002. Premium cessions, on a funds withheld basis in 2001, were \$68,758,000. As of December 31, 2004 and 2003, the Pool Participants have reinsurance recoverable balances of \$76,547,000 and \$108,499,000, respectively. The Company's ceded premiums, losses and recoverable balances represent its 76% share of the pool balances stated above.

In June 2002, the Pool Participants entered into an adverse development contract, effective September 30, 2001 with North American Specialty Insurance Company, a subsidiary of Swiss Reinsurance America Corporation. The contract provides \$400,000,000 of reinsurance coverage for accident years 2000 and prior for all lines of business. As of the examination date, the Pool Participants have ceded the following:

| | Losses | Premiums |
|------|---------------|--------------|
| 2004 | \$140,565,000 | \$58,056,000 |
| 2003 | 10,446,000 | 3,656,000 |

| | | |
|--------|--------------------|-------------------|
| 2002 | 10,000,000 | 3,500,000 |
| 2001 | <u>210,000,000</u> | <u>84,786,000</u> |
| Totals | \$371,011,000 | \$149,998,000 |

The Company's ceded losses and premiums represent its 76% share of the pool ceded losses and premiums in the table above. The coverage remaining on this treaty is \$28,989,000 and is available for asbestos development for the Pool Participants.

In June 2002, the Pool Participants entered into an adverse development contract, effective September 30, 2001 with Inter-Ocean Reinsurance Company, Ltd. (Inter-Ocean), a Bermuda insurer. The contract provides \$100,000,000 of coverage, for carried reserves as at March 31, 2001, for accident periods August 13, 1998 and prior. Coverage varies for specific classes of losses and is subject to sub-limits. As of the examination date, the Pool Participants have ceded \$ 65,249,000 in losses and incurred premium costs of \$32,596,000. None of the remaining coverage on this treaty is available for asbestos development. The Company's ceded losses and premiums represent its 76% share of the pool ceded losses and premiums stated above.

In 1998, in connection with the acquisition of the Company by FFH, the Pool Participants entered into an aggregate stop-loss agreement with Inter-Ocean, which provided coverage of \$367,500,000 and has been fully utilized by the Pool Participants. This contract provides coverage for loss reserve development for August 13, 1998 and prior, the date of the acquisition of the Company by Fairfax. The Pool Participants amended the contract in 2001 to provide additional coverage of \$19,248,000 which has been fully utilized by the Pool Participants.

The arrangements described above with North American Specialty Insurance Company and Inter-Ocean are recorded as retroactive reinsurance, as outlined in SSAP No. 62 (please see Notes to Financial Statements, No. 8 for more information).

ACCOUNTS AND RECORDS

The Company's accounts and records are maintained in Morristown, New Jersey, various branch offices throughout the United States, and Livingston, New Jersey. The Company utilizes a third party data center in Livingston, New Jersey for processing, updating and storing primary records in a mainframe environment.

A high level assessment of internal control structure and process for the Company's accounting and computer systems was discussed with management and reviewed after completion of questionnaires developed by the NAIC and the Delaware Department of Insurance. The discussions and review did not reveal any material deficiencies in the Company's internal control structure.

An external accounting firm audits the statutory-basis financial statements of the Company annually. The Company's external firm reviewed the internal control structure in order to establish the necessary audit procedures required to express an opinion on the December 31, 2004 financial statements. No significant or qualifying deficiencies were found to exist in the design or operation of the internal control structure.

Based on the examination review of the filed Annual Statement, observations, and subsequent discussions with management, the accounting systems and procedures generally conform to insurance accounting practices and requirements.

FINANCIAL STATEMENTS

The following financial statements as determined by this examination are presented herein:

Analysis of Assets as of December 31, 2004
Liabilities, Surplus and Other Funds as of December 31, 2004
Underwriting and Investment Exhibit – Statement of Income, 2004
Capital and Surplus Account for the one-year period ending December 31, 2004

Analysis of Assets
As of December 31, 2004

| <u>Assets</u> | <u>Assets</u> | Non-Admitted <u>Assets</u> | Net Admitted <u>Assets</u> | <u>Note</u> |
|---|-------------------------|-------------------------------|-------------------------------|-------------|
| Bonds | \$1,407,220,880 | | \$1,407,220,880 | (1) |
| Common stocks | 648,371,031 | | 648,371,031 | (2) |
| Cash on hand and on deposit and short-term investments | 457,634,636 | | 457,634,636 | (3) |
| Other invested assets | 51,333,355 | | 51,333,355 | (4) |
| Receivable for securities | 42,148,218 | | 42,148,218 | |
| Investment income due and accrued | 24,410,438 | | 24,410,438 | |
| Uncollected premiums and agents balances in course of collection | 58,826,348 | \$4,549,636 | 54,276,485 | |
| Premiums, agents balances and installments, booked but deferred and not yet due | 69,021,256 | 1,286,845 | 67,734,411 | |
| Accrued retrospective premium | 56,856,121 | 7,161,260 | 49,695,088 | |
| Amounts recoverable from reinsurers | 39,126,476 | | 39,126,476 | |
| Current federal and foreign income tax recoverable | 510,221 | | 510,221 | |
| Net deferred tax asset | 50,644,933 | | 50,644,933 | |
| Guaranty funds receivable on deposit | 7,018,233 | | 7,018,233 | |
| Electronic data processing equipment | 109,246 | | 109,246 | |
| Furniture and equipment | 802,839 | 802,839 | 0 | |
| Receivables for parent, subsidiaries and affiliates | 671,821 | | 671,821 | |
| Other assets non admitted | 2,494,034 | 2,494,034 | 0 | |
| Aggregate write-ins for other than invested assets | <u>54,857,371</u> | <u>21,515,584</u> | <u>33,341,787</u> | |
| Totals | <u>\$ 2,972,057,457</u> | <u>\$ 37,810,198</u> | <u>\$ 2,934,247,259</u> | |

Liabilities, Surplus and Other Funds
As of December 31, 2004

| | | <u>Note</u> |
|---|----------------------------|-------------|
| Losses | \$1,254,801,395 | (5) |
| Reinsurance payable on paid loss and loss adjustment expenses | 4,671,191 | |
| Loss adjustment expenses | 481,868,298 | (5) |
| Commissions payable | 7,162,105 | |
| Other expenses | 21,453,353 | |
| Taxes, licenses and fees | 26,554,107 | |
| Unearned premiums | 320,070,981 | |
| Dividends declared and unpaid to policyholders | 969,098 | |
| Ceded reinsurance premiums payable | 22,635,026 | |
| Funds held by company under reinsurance treaties | 210,637,338 | |
| Amounts withheld or retained by company for account of others | 49,909,827 | |
| Provision for reinsurance | 12,208,661 | |
| Aggregate write-ins for liabilities | <u>(363,975,064)</u> | (6) |
| Total liabilities | <u>\$2,048,966,316</u> | |
| Aggregate write-ins for special surplus funds | \$ 428,222,606 | (7) |
| Common capital stock | 4,586,262 | |
| Gross paid in and contributed surplus | 279,329,699 | |
| Unassigned funds | <u>173,142,376</u> | |
| Surplus as regards policyholders | <u>\$885,280,943</u> | |
| Total | <u>\$2,934,247,259</u> | |

Underwriting and Investment Exhibit: Statement of Income
For the Year Ended December 31, 2004

| <u>Underwriting Income</u> | | <u>Note</u> |
|--|-----------------------|-------------|
| Premiums earned | \$600,693,218 | |
| Deductions: | | |
| Losses incurred | \$389,661,046 | |
| Loss expenses incurred | 148,007,145 | |
| Other underwriting expenses incurred | <u>162,471,109</u> | |
| Total underwriting deductions | <u>\$700,139,300</u> | |
| Net underwriting gain or (loss) | <u>\$(99,446,082)</u> | |
| <u>Investment Income</u> | | |
| Net investment income earned | \$83,232,814 | |
| Net realized capital gains or (losses) | <u>53,091,871</u> | |
| Net investment gain or (loss) | <u>\$136,324,685</u> | |
| <u>Other Income</u> | | |
| Aggregate write-ins for miscellaneous income | <u>25,983,450</u> | |
| Net income before federal income taxes | \$62,862,053 | |
| Federal income taxes incurred | <u>19,292,384</u> | |
| Net Income | <u>\$43,569,669</u> | |

Capital and Surplus Account

| | | |
|---|----------------------|-----|
| Surplus as regards policyholders, December 31, 2003 | <u>\$805,780,909</u> | |
| Net income | \$43,569,669 | |
| Change in unrealized capital gains | 54,831,707 | |
| Change in net unrealized foreign exchange | 7,780,780 | |
| Change in net deferred income tax | (9,763,811) | |
| Change in non-admitted assets | 31,579,601 | |
| Change in provision for reinsurance | 3,364,499 | |
| Cumulative effect for changes in accounting principles | 28,137,589 | (8) |
| Dividends paid to stockholder | <u>(80,000,000)</u> | |
| Change in surplus as regards policyholders for the year | <u>\$79,500,034</u> | |
| Surplus as regards policyholders, December 31, 2004 | <u>\$885,280,943</u> | |

EXAMINATION ADJUSTMENTS

No financial adjustments made as a result of this examination.

NOTES TO FINANCIAL STATEMENTS

Note 1

| | |
|--------------|-----------------|
| <u>Bonds</u> | \$1,407,220,880 |
|--------------|-----------------|

Investments in bonds are reported at values (amortized cost) adopted and approved by the Securities Valuation Office (SVO) of the NAIC. Bonds owned by the Company are as follows:

| | |
|------------------------------|----------------------------|
| US Government | \$1,159,996,337 |
| Special Revenue | 515,879 |
| Industrial and Miscellaneous | <u>246,708,664</u> |
| Total | <u>\$1,407,220,880</u> |

Bonds are designated by the SVO with the highest quality being “1” and lowest being “6”. The bond designations are as follows;

| | |
|-----------|----------------------------|
| 1. | \$ 1,367,428,130 |
| 5. | 28,630,631 |
| 6. | <u>11,162,119</u> |
| Total | <u>\$1,407,220,880</u> |

Bonds with carrying values of \$223,894,461 were on deposit with various states or governmental insurance departments in compliance with insurance laws.

Note 2

| | |
|----------------------|---------------|
| <u>Common Stocks</u> | \$648,371,031 |
|----------------------|---------------|

Affiliated common stock investments of \$252,356,161 represent 39% of the total. The largest single common stock investment is in Zenith National Insurance Company

(Zenith) for \$161,503,878 or 25%. The Company owns in excess of 10% of the outstanding shares of Zenith, which pursuant to the SSAP, is to be valued as a subsidiary, controlled, or affiliated entity (SCA). In 2001, the Company submitted a filing for non-control for Zenith, which was approved by the New York Insurance Department. The Delaware Insurance Department has permitted the Company to value Zenith as a non-affiliated investment. During 2005, 1,000,000 shares of the investment in Zenith were sold, resulting in 2,240,447 shares still owned by the Company.

Note 3

| | |
|--|---------------|
| <u>Cash on hand and Short-term Investments</u> | \$457,634,636 |
|--|---------------|

Cash equivalents of \$218,417,341 are primarily amounts held in Canada which represents \$200,747,943. Bonds with carrying values of \$223,894,461 were on deposit with various states.

Note 4

| | |
|------------------------------|--------------|
| <u>Other Invested Assets</u> | \$51,333,355 |
|------------------------------|--------------|

During the review of other invested assets, Schedule BA, limited partnerships, it was determined that the Company did not disclose the following commitments;

| | |
|------------------------|-----------------------------|
| <u>Name</u> | <u>Remaining commitment</u> |
| Pacific Century Fund I | \$10,000,000 |
| Rutland Fund A LP | GBP 5,121,000 |
| Unison Capital | Yen 1,502,244,828 |
| Unison Capital II | \$4,830,722 |

As such,

It is recommended that the Company disclose as required by annual statement instructions, the remaining unfunded capital commitments for partnerships (refer to summary of recommendations).

Note 5

| | |
|---|-----------------|
| <u>Loss Reserves</u> | \$1,254,801,395 |
| <u>Loss Adjustment Expense Reserves</u> | \$481,868,298 |

Loss and loss adjustment expense reserves represent 85.0% of the Company's liabilities as of December 31, 2004. Incurred but not reported reserves (IBNR) constituted 44% of loss reserves at year-end 2004.

INS Consultants, Inc. (INS) was retained by the Delaware Insurance Department to conduct a review of the Company's reserve methodologies and adequacy. INS evaluated the Company's book of business by line of business for loss and allocated loss adjustment expenses. The conclusions reached by INS are largely based upon information supplied by the Company's staff, which included an in-depth actuarial analysis. The INS reserve analysis was performed on both a gross basis and net of reinsurance and did not address the collectibility of reinsurance recoverables. The INS reserve review found the Company's combined net loss and loss adjustment expense reserves were adequate to support the business underwritten.

The underlying data was tested through a review of open and paid claim files and actual payments made with no exceptions noted. The aggregated actuarial data provided by the Company was verified and reconciled to Schedule P of the Company's filed annual statement.

Loss and LAE reserves are subject to errors of estimation arising from the fact that the ultimate liability for claims evaluated as of the valuation date are dependent on future contingent events which cannot always be anticipated. The possible occurrence of such events, as well as the inherent uncertainty associated with statistical estimates, allows no

guarantee that the actual ultimate liabilities will be the same as the reserve levels described in this examination report. As a result of this study, the reserves were accepted.

Note 6

Aggregate write-ins for liabilities \$(363,975,064)

Major componenets included in the aggregate write-in lines are the following:

Liabilities for financial instruments \$217,378,200

In July 2004, the Company executed a short sale of approximately \$200 million of Standard and Poor's Depository Receipts (SPDRs) as an economic hedge against the decline in the equity markets. In order to limit potential loss to the Company on the future purchase of the SPDRs, its indirect parent, Holdings purchased a two-year S&P index call option that expires in July 2006. Holdings has guaranteed that the Company obligations under the short transactions will not exceed \$240 million, and to secure such guarantee has pledged the call options in favor of the Company.

Retroactive Reinsurance reserve ceded \$(625,486,081)

This amount is the Company's portion of pooled balances for finite cessions recorded as retroactive reinsurance as outlined in SSAP No. 62.

Note 7

Special Surplus Funds \$ 428,222,606

Amounts ceded under retroactive contracts are recognized as to premiums, as other expenses incurred and, as to losses, as a reduction of other expenses incurred and other liabilities. Losses ceded in excess of premiums paid are recorded as restricted surplus until losses in excess of premiums paid are recovered. The special surplus funds increased from

the prior year amount by \$47,756,067 as a result of retroactive cessions for unpaid losses in excess of premium costs.

Note 8

Cumulative effect of changes in accounting principles \$ 28,137,589

Effective March 30, 2004, the State of Delaware enacted laws to adopt standards established by the National Association of Insurance Commissioners (NAIC). The adoption of the standards resulted in an increase in surplus relating to the recognition of goodwill, subject to limitations.

COMPLIANCE WITH PRIOR EXAMINATION RECOMMENDATIONS

The prior examination, as of December 31, 2001, was performed by the New York Insurance Department. This report on examination has not been issued.

SUMMARY OF RECOMMENDATIONS

- (1) It was noted during our review that the Company's filed annual statement did not reflect the proper ownership percentages. Subsequent to the examination the error regarding ownership percentages was corrected. Voting percentages, however, remain undisclosed, and should be disclosed on the holding company chart. Therefore,

It is recommended that the Company properly disclose the Holding Company voting structure in the filed Annual statement (refer to Holding Company section). (p. 16)

- (2) During the review of other invested assets, Schedule BA, limited partnerships, it was determined that the Company did not disclose the following commitments;

| <u>Name</u> | <u>Remaining commitment</u> |
|------------------------|-----------------------------|
| Pacific Century Fund I | \$10,000,000 |

| | |
|-------------------|--------------|
| Rutland Fund A LP | \$9,831,817 |
| Unison Capital | \$14,660,338 |
| Unison Capital II | \$4,830,722 |

As such,

It is recommended that the Company disclose as required by annual statement instructions, the remaining unfunded capital commitments for partnerships (refer to Notes to Financial Statements). (p. 31)

CONCLUSION

As a result of this examination, the financial condition of the Company, as of December 31, 2004, was determined as follows:

| | 12/31/04 | 12/31/01 | Changes |
|--|------------------------|------------------------|----------------------|
| Description | Current Examination | Prior Examination | Increase (Decrease) |
| Assets | <u>\$2,934,247,259</u> | <u>\$1,990,908,918</u> | <u>\$943,338,341</u> |
| Liabilities | \$2,048,966,316 | \$1,477,381,124 | \$571,585,192 |
| Special surplus funds | \$428,222,606 | 500,304,731 | \$(72,082,125) |
| Common capital stock | 4,586,262 | \$4,586,262 | -0- |
| Gross paid in and contributed capital | 279,329,699 | 274,329,699 | 5,000,000 |
| Unassigned funds (surplus) | <u>173,142,376</u> | <u>(265,692,898)</u> | <u>438,835,274</u> |
| Total surplus as regards policyholders | <u>\$885,280,943</u> | <u>\$513,527,794</u> | <u>\$371,753,149</u> |
| Totals | <u>\$2,934,247,259</u> | <u>\$1,990,908,918</u> | <u>\$943,338,341</u> |

Since the last examination, the Company's assets have increased \$943,338,341; liabilities have increased \$571,585,192; and capital and surplus has increased \$371,753,149.

In addition to the undersigned, acknowledgment is made of the assistance provided by the Delaware Insurance Department's consulting actuarial firm, INS Consultants, Inc.

Respectfully submitted,



Anthony C. Cardone, CFE
Examiner-in-Charge
State of Delaware
Northeastern Zone, NAIC

SUBSEQUENT EVENTS

- (1) On January 25, 2005, the Company executed a short sale of an additional \$100 million SPDRs. In order to limit potential loss to the Company on the future purchase of SPDRs, its indirect parent, Holdings, purchased a two-year S&P Index call option, which expires in January 2007. Holdings has guaranteed that the Company's obligation under this short transaction will not exceed \$120 million and, to secure such guarantee has pledged the call options in favor of the Company. The Company paid Holdings \$2,217,003 in consideration for this guarantee, which equaled the fair market value of the call options at the time of the acquisition.
- (2) On March 14, 2005 the Company declared an \$88,500,000 dividend payable to its sole shareholder, C&F Holding Inc. The dividend was paid on March 31, 2005; the Delaware Insurance Department was properly notified.
- (3) During 2005, the Company holds credit default swap contracts with a term of five years that are designated as ineffective hedges. The Company acquired these contracts at a premium of \$50,086,284 to hedge the exposure of a potential decline, due to default, of the underlying bond obligations. The Company does not own these

underlying obligations in its portfolio. If there is a default, the Company can instruct the counterparty to buy back the bonds and pay the Company the difference between the par value and the buy back price as well as refunding any remaining premium not earned. The carried fair value as at September 30, 2005 was \$38,698,465; unrealized losses amounted to \$11,387,819. This strategy is currently under review by the Delaware Insurance Department.